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Intelligence Memorandum

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Soviets Face Massive Trade Deficit in 1975

SUMMARY

The USSR's hard currency trade deficit in 1975 is now expected to be close to $5 billion. Soviet imports have maintained the record rates reached at the end of 1974, while Soviet export growth continues to be depressed by the recession in the West. Soviet contracts for grain, equipment, and steel presage a continued increase in imports in 1976 and probably a large deficit as well. The size of the 1976 deficit will depend on Soviet export performance, which in turn will be strongly influenced by the rate of recovery from the recession in the West.

A weak gold market in 1975 has forced Moscow to borrow heavily in Western money markets, but the Soviets have had no difficulty in arranging financing to take care of this year's deficit. They also appear to be finding credit to help finance an expected deficit in 1976. If Soviet exports continue to be sluggish in 1976, Moscow may be forced to reduce imports, but there is no evidence of this to date.

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [redacted] of the Office of Economic Research, Code 143, Extension 7107. 25X1A9a

DISCUSSION

Soviet Trade in 1975

1. The Soviet hard currency trade deficit in 1975 is expected to reach a record level near $5 billion. The Soviet Union has continued to increase imports from the West at a time when exports have been limited by recession in the West (see Table 1).

Table 1

USSR: Hard Currency Trade Balance[1]

Billion US $

	Actual 1974	Projected 1975	
	Soviet Statistics	Western[2] Statistics	Soviet[3] Statistics
Soviet exports	7.63	N.A.	8.1
Developed West	6.67	8.0	7.1
Less developed West	0.96	N.A.	1.0
Soviet imports	8.54	N.A.	12.8
Developed West	7.16	11.0	11.4
Nongrain	N.A.	10.0	10.4
Grain	N.A.	1.0	1.0
Less developed West	1.38	N.A.	1.4
Exports minus imports	**-0.91**	N.A.	-4.7

1. Soviet statistics are F.O.B.-F.O.B. Western statistics are usually F.O.B.-C.I.F.
2. Projections are based on partner country data for January-August trade with the United States, West Germany, Japan, France, Italy, and the United Kingdom. January to May data were used for smaller hard currency developed countries. These data were extrapolated separately through the end of 1975 and then summed. Second-half exports were adjusted upward because Soviet exports have in recent years averaged 22% greater in the second half than in the first half. Soviet imports in the second half were adjusted upward by 5% for the same reason. Grain exports were treated separately on the basis of known and estimated shipments.
3. CIA reporting of Soviet trade is traditionally based on Soviet data. Linear regressions were used to estimate Soviet trade data from the projections derived from partner country data. These regressions, which compared Soviet with Western trade data for the 1960-73 period, yielded coefficients of determination greater than 0.99. Soviet reporting of nongrain exports for 1975 are projected at 89% of the level projected from Western data; Soviet reporting of imports is projected at 104% of the level projected from Western data.

2. Hard currency imports in 1975 are expected to be roughly 50% higher than in 1974–itself a record year. In the first nine months, imports from the USSR's six major Western trading partners were running at an annual rate of 58% above last year's. Soviet imports of Western machinery and equipment should be on the order of $4 billion, compared with $2.3 billion last year. During the first six months, Soviet machinery imports from major suppliers were up by an average of 70% over

the same period last year (see Table 2). Higher prices are responsible for a part of this increase, particularly for those items ordered last year when prices were rising rapidly in the West. Signed contracts with Western manufacturers also indicate a rise in the volume of Soviet steel imports. During the latter half of 1975, grain imports will rise substantially and should more than offset any possible cuts made in other areas. Of the roughly $1 billion worth of Western grains scheduled to be delivered in 1975, most will come in the second half of the year.

Table 2

USSR: Imports of Western Machinery and Equipment[1]

Million US $

	First Half 1974	First Half 1975
Total	567	965
France	114	194
Japan	57	113
United Kingdom	26	75
United States[2]	101	177
West Germany	269	406

1. Comparisons based on SITC category 7 for the United States and Japan and on BTN category 84 for France and West Germany.
2. During July-September 1975, US firms delivered an additional $154 million in machinery to the USSR.

3. Soviet hard currency exports may also rise in 1975, but probably by no more than 6%. The USSR's exports to its six major Western trading partners in the first three quarters of this year were 4% below the January-September figure for last year.[1] Soviet exports have traditionally been higher in the second half of the year[2] and—despite the lack of evidence of any such growth thus far—several factors indicate that this trend will be repeated this year. The USSR is known to have reduced its prices on several commodities, including diamonds, platinum, and palladium, to make these products more competitive. The Soviets also have contracted to sell more oil than in the first half of the year. Moreover, they are rumored to be offering significant amounts of crude oil to the West at a 15% discount from OPEC prices.[3] Moscow is known to be pressuring Western governments to increase imports of Soviet products to redress current trade

1. Italian imports for August and September are estimated.

In 1974, despite a recession-related drop in the fourth quarter, Soviet exports rose by 20% in the second half of the year.

3. Such discounts are contingent on the use of Soviet tankers.

imbalances. Western economic recovery should raise some Soviet exports in the last quarter, but the largest Soviet markets—those in Western Europe—remain very sluggish.

Financing the 1975 Deficit

4. The USSR will finance this year's deficit through a combination of nontrade revenues, gold sales, drawings on Western credits (see Table 3), and a probable reduction in foreign exchange holdings. Roughly 20% of the deficit will be covered by revenues from non-trade sources. Arms sales for cash--principally to Libya and Nigeria—should earn Moscow between $300 million and $500 million. In spite of costs associated with grain shipments, the USSR will probably net $410 million from transportation charges. Net revenues from tourism should exceed $150 million.

Table 3

USSR: Financing the Hard Currency Trade Deficits

Million US $

	1974	1975 (Preliminary)
Hard currency trade deficit	-911	-4,700
Financing	1,845	4,000 to 5,000
Gold sales	350	1,000
Other current account	675	500
Medium- and long-term credits, net of principal repayments	820	2,500 to 3,500
Changes in short-term capital, foreign exchange holdings, and errors and omissions[1]	-934	700 to -300

1. A negative number indicates an increase in Soviet holdings of foreign currencies and/or improvement in the USSR's net short-term position.

Gold

5. The USSR probably will earn about $1 billion from gold sales in 1975, even though Moscow's gold sales have declined greatly as the gold market weakened in recent months. Confirmed sales during the first seven months totaled 75 tons and earned more than $400 million. In July, Moscow was rumored to have sold 50 tons

of gold directly to Middle East buyers. These sales have still not been confirmed,[4] but if true they would have earned about $275 million. We believe that Moscow continued to sell gold in August when prices were still favorable. Sales of just 20 tons at average August prices could have earned Moscow another $100 million. Soviet sales probably were small during September when gold prices plunged following the International Monetary Fund's announcement that it would sell gold. Given the USSR's trade deficit, it would not be surprising if Moscow re-entered the market in October when gold prices recovered and appeared to stabilize at around $145 per troy ounce. Sales of about 20 tons per month during the last quarter—a reasonable estimate based on past Soviet sales and assuming stability in the gold market—could earn Moscow another $275 million.

Credits

6. The major share of the 1975 deficit—$2.5-$3 billion—will be financed by a combination of Soviet borrowing in the West and probably a reduction in foreign exchange holdings.

- Soviet Eurocurrency deposits in London almost doubled in 1974 to $1.3 billion at yearend, and it seems probable that the Soviets held sizable assets with continental banks as well. By June 1975, Soviet assets in London had been reduced to $931 million and very likely have fallen even further since that time.

- Medium- and long-term credits extended in earlier years on the basis of contracts placed in the West (largely government-guaranteed) will cover a major share of Soviet imports of Western capital goods and large-diameter pipe. On the basis of expected deliveries, Soviet drawings for this purpose should exceed $2.5 billion in 1975, yielding more than $1.4 billion in net credits after repayments.

- Earlier this year, Moscow arranged for three consortium loans totaling $400 million. The five-year notes may have been intended to finance anticipated cash purchases.

- [redacted] 25X1X

4. A spokesman of the Soviet-owned Moscow Narodny Bank in London partly confirmed these rumors by admitting to "some" gold sales to the Middle East.

25X1X [redacted]

- The Soviets have arranged for additional bank-to-bank credits in Europe and in the United States. According to one report, the USSR now has lines of short- and medium-term credit with US banks "approximately $1.2 billion higher than credit lines available earlier in the year." Most of these lines are probably medium-term and are tied to Soviet purchases of US equipment or grains.

7. Since the middle of the year, Soviet efforts to raise loans in Europe and the United States have shown a marked upswing. These efforts are probably designed mainly to meet next year's obligation.

- The Soviets requested a major US bank to arrange a $400 million Eurodollar loan on their behalf. The loan, while contracted for, has yet to be syndicated.

- A second $400 million, five-year loan involving the participation of a major US bank is currently being syndicated in Europe and should be ready in December.

- A $500 million, five-year loan is reportedly being arranged by a syndication of 12 West European banks on Soviet behalf.

- The Soviets recently visited US bankers, reportedly to arrange additional large-scale financing for future Soviet purchases in the United States.

Trade in 1976

8. The USSR will run a substantial trade deficit in 1976. Existing orders should result in perhaps $3 billion worth of grain imports. If additional orders are placed in the United States, as is now anticipated, grain imports could be as much as $4 billion. Machinery and equipment imports may also exceed 1975 levels. The USSR will also import a record value of large-diameter pipe in 1976. There has been no evidence to suggest that Moscow intends to cut back other imports, including consumer goods, although it is too early to judge.

9. The size of the 1976 deficit will depend largely on the ability of the Soviet Union to revive its hard currency exports to the West. Specifically, recent discussions presage an increase in Soviet oil exports in 1976 and signed contracts call for a sizable increase in Soviet natural gas deliveries to Western Europe. Moscow can also be expected to intensify current efforts to boost export volume by shaving prices and pressuring Western governments to correct current trade imbalances by taking more Soviet goods.

Implications of the Deficits

10. Soviet use of Eurocurrency funds for grain purchases may reduce the USSR's access to the Eurocurrency market to finance capital goods purchases during the next several years. Moscow may be forced to pay higher rates for Eurocurrency loans and to be more selective in the projects using this financing. As a result, Moscow may push for even larger commitments from Western governments for subsidized credit lines to cover Soviet purchases during 1976-80.[5]

11. The USSR's medium- and long-term debt will grow substantially during 1975-76 as a result of the massive borrowing—perhaps to more than $7 billion this year (see the chart) and close to $10 billion by yearend 1976. Debt service will not rise substantially until 1977-78, however, because Moscow apparently has been granted grace periods for at least some of its Eurocurrency loans.

12. If the Soviet Union is unable to increase its exports substantially next year, the leadership may be faced with some hard decisions. These include: a possible cutback in imports such as consumer goods or plants to produce consumer goods, a delay in delivery schedules for equipment already ordered and not covered by long-term government-guaranteed credit, and a cutback in the value of capital goods orders requiring cash payment.

Soviet Reaction to the Deficits

13. Although so far the Soviets appear to be taking the deficits in stride, they are undoubtedly concerned about their hard currency position. Available reporting on Soviet reactions to the deficits is mixed.

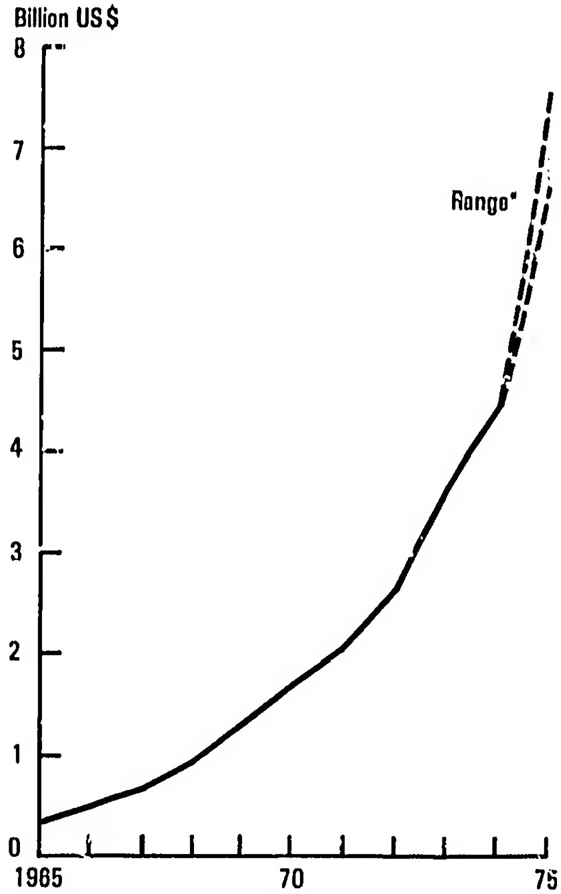
- Orders placed in the West for machinery and equipment have been on the rise since midyear because the USSR is placing contracts for the 1976-80 plan backed by long-term government-guaranteed credits.

5. Since mid-1974, Moscow has obtained roughly $9 billion from Canada, Italy, France, the United Kingdom, and Japan.

- There has been no indication of a desire to push back deliveries for previously ordered equipment. Negotiations on major projects have continued. Although there has been some indecision over some projects such as those dealing with the development of aluminum processing facilities, these do not appear to be tied to hard currency problems.

- The Soviets continue to open negotiations for major purchases. Over the last few months, for example, the USSR has approached Japanese businessmen about purchasing more than $1.5 billion worth of nuclear reactor parts and roughly $1 billion worth of ships.

USSR: Medium-and Long-Term Debt



*The $1 billion range included in the estimated Soviet debt for 1976 is due to uncertainties concering the timing of Soviet drawings and Moscow's use of cash assets to finance the 1975 deficit.

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- On the other hand, US businessmen report that the current hard currency shortage may be adversely affecting longer term planning as well as current negotiations, and in recent trade negotiations with Japan, Soviet negotiators repeatedly cited hard currency shortages as the reason for limiting the projected Soviet imports of Japanese products during 1976-80.